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October 21, 2008

AGENDA ITEM 6

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: Impact of Recent Investment Market Downturn on Employer Rates

II. PROGRAM: Retirement

III. RECOMMENDATION: Information Item

IV. ANALYSIS:

The agenda item is being presented to this committee to discuss the impact of the recent investment market volatility. As you are well aware, investment markets have declined substantially since the beginning of this fiscal year. As of October 10, 2008, the CalPERS fund had lost more than 20% of its value since July 1, 2008.

Such decline will no doubt have an impact on the funded status of plans at CalPERS and on the contribution rates that employers will have to pay in the future.

The good news is that cushioning the impact of investment set backs is the fact that CalPERS experienced double digit gains in the four years leading up to the 2007-2008 fiscal year. In previous down markets, flat or negative investment returns contributed substantially to increases in employer contributions the following year. However, CalPERS rate stabilization policies now spread market gains and losses over 15 years, thus reducing the volatility of employer rates.

As of June 30, 2007, the asset smoothing method had set aside most of the prior investment gains. In the June 30, 2007 valuations, the actuarial value of assets used to set employer contribution rates was about 86% of the market value of assets for all plans. In fact, one can say that about 14% of the fund on June 30, 2007 was set aside for a rainy day.

On June 30, 2007, the funded status of plans at CalPERS were as follows:

	Funded Status on a Market Value of Assets Basis as of June 30, 2007
CalPERS	102%
State plans	97%
Schools pool	108%
Average Public Agency Miscellaneous Plan	103%
Average Public Agency Safety Plan	99%

The June 30, 2007 valuations were used to set employer contribution rates for fiscal year 2008-2009 for the State plans and the Schools pool and for fiscal year 2009-2010 for public agency employers.

In fiscal year 2007-2008, the investment return was about -2.5%. This was about 10% less than the actuarially assumed investment return of 7.75%. This 10% difference will reduce the funded status of all plans by about 10%. The table below provides the estimated funded status of plans at CalPERS on June 30, 2008.

	ESTIMATED Funded Status on a Market Value of Assets Basis as of June 30, 2008
CalPERS	92%
State plans	87%
Schools pool	98%
Average Public Agency Miscellaneous Plan	91%
Average Public Agency Safety Plan	87%

As stated earlier, previous investment gains of about 14% of the market value of the fund had been set aside as of June 30, 2007 for a rainy day and the fund earned about 10% less than expected during the fiscal year 2007-08. Therefore, previous investment gains of about 4% of the market value of the fund are available to mitigate potential investment losses in fiscal year 2008-2009.

The investment return for fiscal year 2007-08 first impacts employer rates for the State and School plans in fiscal year 2009-2010 and rates for local government employers in fiscal year 2010-2011. While that return will impact each plan differently, on average, plans will see reductions in rates of about 0.1% to 0.2% of payroll in the fiscal years quoted if all other assumptions are realized. It is important to note that in recent years the demographic experience of most plans has been such that employers saw increases in rates.

As of October 10, 2008, the CalPERS fund has lost more than 20% of its value since July 1, 2008. However, we are still 8 months away from the end of the fiscal year and the markets still have time to turn around.

The table below provides estimated funded status as of June 30, 2009 under various investment return scenarios.

ESTIMATED Funded Status on a Market Value of Assets Basis as of June 30, 2009 Based on Hypothetical Investment Returns

	Hypothetical Investment Return for 2008-2009						
	-20% Return	**-15% Return**	**-10% Return**	**0% Return**	**7.75% Return**	**10% Return**	**20% Return**
CalPERS	68%	73%	77%	85%	92%	94%	103%
State	65%	69%	73%	81%	87%	89%	97%
Schools	72%	77%	81%	90%	98%	100%	109%
PA (Misc)	68%	72%	76%	85%	91%	93%	102%
PA (Safety)	65%	69%	73%	81%	87%	89%	97%

As a result of the rate stabilization methods adopted by the Board, the impact on employer rates will be greatly mitigated. The methods impose a corridor of 80%-120% of market value of assets on the actuarial value of assets. That means that when setting rates, the actuarial value of assets can not be more than 120% of the market value nor less than 80% of the market value.

It would take a return of about -16% before the corridor limit comes into play. Any return less than -16% would produce a greater impact on employer rates. Note that the impact on employer rates will vary from plan to plan. Below is a table showing the estimated impact of various 2008-2009 investment returns on employer rates.

ESTIMATED Change in Employer Contribution Rates based on actuarial valuation as of June 30, 2009

	Hypothetical Investment Return for 2008-2009						
	-20% Return	**-15% Return**	**-10% Return**	**0% Return**	**7.75% Return**	**10% Return**	**20% Return**
Range of Estimated Changes in Rates	Increase of about 2% to 4% of Payroll	Increase of about 0.3% to 0.6% of Payroll	Increase of about 0.2% to 0.5% of Payroll	Increase of about 0.1% of Payroll	Decrease of about 0.1% to 0.2% of Payroll	Decrease of about 0.1% to 0.3% of Payroll	Decrease of about 0.3% to 0.6% of Payroll

These employer contribution rate changes would occur in fiscal year 2010-2011 for the State and Schools plans and for fiscal year 2011-2012 for local public agency employers.

Beyond those fiscal years, if CalPERS does experience a negative return in 2008-2009 as illustrated above, then employer rates would likely continue to rise slowly over time even if CalPERS earns its anticipated 7.75% return. It would take returns well in excess of 7.75% in subsequent years to prevent a steady rise in employer rates.

If for example the investment return in 2008-2009 remains at -20% for the fiscal year, investment returns of 7.75% in the next few years would result in increases in employer rates of about 0.2% to 0.6% of payroll each year. Under that scenario, it would take a return in excess of 28% in 2009-2010 to prevent further increases in rates in subsequent years.

V. STRATEGIC PLAN:

This item is not a specific product of the Strategic or Annual Plans but is part of the regular and ongoing workload of the Actuarial & Employer Services Division.

VI. RESULTS/COSTS:

See Above.

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